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The International Comparative Legal Guide to:

Corporate Recovery & Insolvency 2007

A practical insight to cross-border Corporate Recovery & Insolvency

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1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in your jurisdiction?

The granting of a specific type of security may depend on various aspects, such as, the nature of the asset over which the security is granted and the nature of the secured obligations. When the assets secured correspond to real property, the debtor may grant a mortgage in favour of the creditor. The creation, validity, perfection and enforceability of a mortgage depend on its execution being carried out in a public document performed before a notary and it shall be registered. In case of moveable assets, the creditor may enter with the debtor into a pledge agreement over the secured moveable assets, such as, amongst others, shares, receivables, bank accounts, etc.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

There are several types of transactions which can be challenged once insolvency proceedings have been started. All the acts that may be qualified as disadvantageous to the insolvent estate, like the diminishing, frustration, aggravation, putting in danger or delay the rights of the creditors, performed within four years prior to the beginning of the insolvency proceedings, may be attacked on behalf of the insolvent estate. In these cases, the termination of said transactions is only possible if the third party had wrongful intent.

Upon the declaration of insolvency, all transactions must be, in principle, entered into with the insolvency administrator. According to article 81 of the Insolvency Code, all transactions entered into by the debtor after the declaration of insolvency are not binding upon the insolvent estate with the latter being entitled to return any moneys received from those transactions, according to the rules regarding unjust enrichment ("*enriquecimento sem causa*").

Notwithstanding the above, provided that those legal transactions (i) are onerous, (ii) have been entered into with third parties acting in good faith prior to the declaration of insolvency, and (iii) are not permitted to be annulled on behalf of the insolvent estate under the terms of article 120 of the Insolvency Code, such transactions shall be considered valid.

On the other hand, certain acts may be annulled on behalf of the insolvent estate even if they were not performed within four years prior to the beginning of the insolvency proceedings: (i) acts performed free of charge which involve a reduction of the debtor's assets if performed within two years prior to the beginning of the insolvency proceeding; (ii) creation of liens by the debtor in relation to prior obligations or bond, collateral and credit mandates granted or accepted by the debtor less than six months before the beginning of the insolvency proceedings and which relate to transactions without any real benefit to the debtor; (iii) granting of security over real property simultaneously with the execution of granted obligations within sixty days prior to the opening of the insolvency proceedings; (iv) payment or set off of debts which would become due after the date on which insolvency proceedings are initiated if such payment or set off occurs during the six months prior to the beginning of the insolvency proceeding or if such payment or set off is considered unusual according to standard trade rules and the creditor was not able to demand payment; (v) onerous acts carried out by the debtor within a year prior to the beginning of the insolvency proceeding in which the obligations assumed by the debtor significantly exceed those of the counterparty; and (vi) reimbursement of shareholders' loans made during the year before the beginning of the insolvency proceeding.

Additionally to the abovementioned situations, other transactions carried out with wrongful intent can be attacked. For this purpose, wrongful intent means the knowledge, at the date the act was performed, (i) that the debtor was in an insolvent situation, (ii) of the prejudicial nature of said act to the debtor's situation, or (iii) that the insolvency proceeding had already been initiated.

Any creditor or the Public Prosecutor is entitled to bring a claim challenging a transaction. Any assets or benefits resulting from an act of annulment or defence for fraud against creditors revert to the insolvent estate. The courts have sufficient powers to guarantee that the final awards arising from these legal procedures are effectively executed.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in your jurisdiction?

Under the Insolvency Code, there are grounds on which shareholders, managers or directors (including shadow directors) can face not only criminal or civil liability but also restrictions on their personal and professional activities or careers.

When the insolvency situation was deemed to be caused by the directors actions, the court must (i) identify the person(s) responsible for the insolvency; (ii) order his or their civil incapacity for a period of 2 to 10 years, in which case the court may appoint a trustee to these persons during said period; (iii) prevent the

responsible persons from performing commercial activities for a period of 2 to 10 years, including as a member of the board of directors of any commercial or civil company, of any private association or foundation with economic activity, public companies or cooperatives; (iv) order that these persons may not be, in any way, considered as creditors of the company and oblige them to return to the insolvent estate any amount already received by them resulting from any personal claim against the insolvent estate.

On the other hand, if the director(s) of a company in financial difficulties, with a fraudulent intention to damage the creditors, destroys, harms, makes useless or dissolves part of the assets, deceptively decreases the company's assets or artificially creates, increases or reduces the profits and, by doing so, puts the company into an insolvent situation, such director(s), provided that the company is declared insolvent, may be subject to a five-year imprisonment penalty or to a fine.

The director who, being aware that the company is or is near to a situation of insolvency and with the intention of protecting some creditors, starts making undue payments, payment of debts before their due date or granting security for debts which he is not obliged to grant, may be punished, if the company is declared insolvent, with up to two years of imprisonment penalty or a fine.

All these penalties may be aggravated if the claims of the company's employees are not duly paid as a consequence of the behaviour in question.

In addition to criminal penalties, creditors may also claim for civil damages for all the losses incurred, including loss of profits, according to the civil liability rules in force.

1.4 Is it common to achieve a restructuring outside a formal procedure in your jurisdiction? In what circumstances might this be possible?

Decree-Law no. 316/98, 20 October, as amended by Decree-Law no. 201/2004, 18 August, implemented an out-of-court conciliatory proceeding, allowing the companies in financial difficulties to achieve a restructuring without entering into a formal judicial proceeding. This proceeding is subject to the same requirements of the formal insolvency proceedings and involves an agreement between the debtor and all or some of the creditors concerning the recovery of the company. The company's shareholders may also be parties to such agreement.

All the parties involved are free to settle the terms of the agreement. It is possible to choose any method of recovery, including those set out in Decree-Laws no. 14/98, 28 January, and no. 81/98, 2 April. This proceeding is supervised by a public institute - the Institute for the Assistance of Small and Medium Firms and Investments ("*Instituto de Apoio às Pequenas e Médias Empresas e Investimento* - IAPMEI") who is in charge of making the debtor and creditors to reach an agreement and approve the terms of the same.

In the event IAPMEI considers that the economical recovery of the debtor is unfeasible, it shall order the immediate termination of the procedure. IAPMEI should also analyse the debtor's capacity to execute the terms of the proposed agreement.

There are also special regimes regarding financial security contracts.

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in your jurisdiction?

The Insolvency Code, dated of September 15, 2004, establishes a single main insolvency proceeding, called "*processo de insolvência*". The main goals of the insolvency proceeding are: (i) the liquidation of the insolvent debtor's estate and the distribution of the proceeds amongst the creditors pursuant to the terms of the legal supplementary regime; or (ii) to establish the terms of an insolvency plan in order to recover the insolvent company or to liquidate the insolvent debtor's estate, according to the rules settled by the creditors upon resolution.

The insolvency proceedings may, after the insolvency's declaration having been issued by the court, lead to the immediate liquidation of the company or to the approval of an insolvency plan. This is determined by the creditors whose powers to determine the future of the insolvent company are significantly increased under the Insolvency Code.

2.2 What are the tests for insolvency in your jurisdiction?

The debtor is considered to be insolvent when he is not able to comply with his obligations in due time. If the debtor is a company, it will be deemed insolvent when the aggregate value of its debt is higher than the value of its assets determined upon a fair assessment.

However, in certain cases, when the aggregate value of the company's assets is higher than the company's debts, the latter can be deemed insolvent if the assessment was made pursuant to the rules set forth in article 3. nr. 3 of the Insolvency Code.

2.3 On what grounds can the company be placed into each procedure?

Insolvency proceedings may be filed by the debtor, any of its creditors (regardless the nature of the credit), any person who is responsible for the debtor's debts or by the Public Prosecutor.

However, the directors of a company have an obligation to file for insolvency within sixty days from the date on which they become aware or should have become aware of the situation of insolvency. In case they do not fulfil this obligation, they may incur, for the abovementioned crimes and/or in civil liability, other penalties.

The insolvency proceeding may be started, for example, in the following cases: (i) general default of the debtor's payment obligations; (ii) the disappearance of the members of the board of directors or of the shareholders of the company, due to its liquidity problems, without an appropriate substitute being appointed, or where the registered office or the main establishment of the debtor has been abandoned/closed; (iii) debtor's failure to pay, within the six-month period preceding the filing for involuntary insolvency, its (a) tax liabilities; (b) social security obligations; (c) salary and other monetary employment obligations; or (d) any rent, leasing, purchase or loan contract secured by mortgage regarding the premises of the company (including its registered office); or (iv) if the debtor is a company when the liabilities clearly exceed the company's assets according to the last approved balance sheet or where there is a delay of at least nine months in approving the accounts of the company.

2.4 Please describe briefly how the company is placed into each procedure.

To start insolvency proceeding, it is necessary to file a written petition at the insolvency court or, if not existing, at the general district court, with jurisdiction over the location of the debtor's registered office, domicile or centre of main interests. The insolvency petition, either filed by the debtor or by a creditor, must comprise the following elements: (i) an indication as to whether the insolvency situation is existing or imminent; (ii) identification of the company's directors and of its five major creditors, excluding the petitioner; (iii) the debtor's certificate issued by the commercial registry office; (iv) a list of all known creditors and the details of each claim and all pending lawsuits brought up against the debtor; (iv) a comprehensive explanation of the company's activities over the last three years, as well as all the debtor's establishments; (v) identification of all the shareholders and associates of the debtor and those who may be liable for the company's debts; (vi) a list of all the company's assets and rights, whatever their nature; (vii) the accounting books of the company; and (viii) a list of all the debtor's employees.

In addition, a petition submitted by a creditor or by a Public Prosecutor shall include details on the relevant claim, and any information available relating to the assets and other liabilities of the debtor as well as evidence of any of the circumstances indicated in the question 2.2 above.

2.5 What notifications and meetings are required after the company has been placed into each procedure?

Whenever the petitioner is a creditor or the Public Prosecutor, upon the receipt of the written petition, and where no reasons for the immediate rejection of that petition exist, the court shall notify the debtor to, within ten days, submit a pleading challenging the insolvency petition, either by invoking that the facts alleged by the creditor are false or that there is no insolvency situation. If the debtor intends to challenge the facts included in the petition, it must provide clear evidence, based on the accountancy books of the company, that it is not in an insolvency situation. If and when the debtor does not oppose the petition filed by any creditor or by the Public Prosecutor, the court should immediately declare the insolvency of the debtor.

If the debtor submits a pleading challenging the insolvency petition, the court must settle a date for the hearing of the petitioner and the debtor within the following five days. After the hearing, the court shall, in five days, declare the insolvency of the company or order the closing of the proceedings; the declaration of insolvency of the company may be challenged in a superior court.

2.6 How does somebody establish whether the company has been placed into one of these procedures?

The court's declaration of the debtor's insolvency and the appointment of the insolvency administrator must be published in the Portuguese Official Gazette ("*Diário da República*") and registered at the debtor's commercial registry. The debtor's insolvency will also be published through announcements displayed in a court building and at the debtor's registered office. The administrator's substitution and the termination of the proceedings shall also be published and registered in the same terms.

Since September 2003, the Ministry of Justice maintains a computerised registry of all the foreclosure proceedings and insolvency decisions. The terms of access are regulated under Decree-law no. 201/2003, 10 September. The access is limited to: (i) Judges and prosecutors; (ii) lawyers upon the exhibition of any document proving the existence of a claim; and (iii) parties to a contractual or pre-contractual relationship and all those who demonstrate a relevant interest in the search. Details of the insolvency proceedings pending at the Portuguese courts, including the deadline for submitting creditors' claims, are also available online, at the court's official website (www.tribunaisnet.mj.pt).

3 Creditors

3.1 Are unsecured creditors free to enforce their rights in each procedure?

Unsecured creditors have to claim for its rights in the insolvency proceeding within thirty days from the declaration of the debtor's insolvency issued by the court.

Once this term is elapsed, unsecured creditors may still claim its credits through a lawsuit brought against the insolvent estate, the other creditors and the debtor. This lawsuit must be filed within the term of one year after the declaration of insolvency. However, creditors who have been personally notified of the declaration of insolvency are not entitled to file this claim.

Claims presented by unsecured creditors, whose rights have been acknowledged by the court, will be paid on a pro rata basis, depending on the value of the insolvent assets, and only provided that all the other debts of the insolvent estate have been paid.

3.2 Can secured creditors enforce their security in each procedure?

Secured creditors are usually notified of the declaration of insolvency since their credits are, in principle, registered at the relevant Registry Offices (Commercial or Land Registry). In view of this, they are only entitled to claim for the amounts owed to them in the insolvency proceeding within thirty days from that declaration.

In view of the above, creditors with security over real property owned by the debtor are firstly paid by the proceeds which arise from the sale of such assets. In the event those proceeds are not sufficient to pay the full amount owed to the creditor, the outstanding amount will be treated as an unsecured claim.

Even where a security was granted in favour of the creditor, 10% of the proceeds arising from the sale of the respective assets shall be used to pay the debts of the insolvent estate.

3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

Set-off is permitted where the sums owed by the company to a creditor and owed by the latter to the company are mutual, both enforceable, due and payable. Set-off is still permitted if the claims are expressed in different currencies provided that free and reciprocal conversion is permissible.

Provided that the set-off criteria are met prior to the beginning of insolvency proceedings, both debtors and creditors are entitled to set off their claims after the commencement of the insolvency proceedings.

However, set-off will not be permitted: (i) if the debt to the insolvent estate arose after the date of the declaration of insolvency; (ii) if the insolvency creditor acquired its claim from a third person

after the beginning of the insolvency proceedings; (iii) in relation to debts of the insolvent company for which the insolvent estate is not liable; or (iv) between debts to the insolvent estate and subordinated claims against the insolvent estate.

4 Continuing the Business

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

After the declaration of insolvency, the company is controlled by the insolvency administrator. The administrator is entitled to perform all acts and carry out all transactions within the ordinary course of business in order to allow the continuation of the company's trading. He is also responsible for collecting the company's assets (and in doing so, he is entitled to bring up legal actions against the company's debtors), selling all the assets of the company and making all the arrangements in order to pay the creditors and the debts owed by the insolvent estate.

The directors and the shareholders of the company will maintain their functions and competencies. However, directors may not receive any remuneration being entitled to resign from their offices. Both directors and shareholders are obliged to: (i) provide all the relevant information requested by the insolvent administrator, by the creditors' assembly, by all of the creditors and by the court; (ii) attend, personally, the court if the judge determines that; and (iii) be cooperative with the insolvency administrator.

4.2 How does the company finance these procedures?

The court costs of the insolvency proceedings, the fees and expenses of the administrator, and the expenses of the members of the creditors' committee are, in principle, borne by the insolvent estate. However, if proceedings are closed before the insolvency is declared, the court costs shall be borne by whoever started the proceedings. The fees of the administrator are fixed by the judge according to legal criteria such as the fees of the management of the company, the opinion of the creditors and the services that he is expected to perform. The members of the creditors' committee do not receive any fees.

At any time during the insolvency proceeding - even before the declaration of insolvency - the court may order, upon hearing the debtor, the creditors' assembly and the creditors of the insolvent estate, the immediate closing of the proceedings if the insolvent estate is not sufficient to bear the court costs and the remaining debts of the insolvent estate (unless any interested person guarantees the payment of the court costs and the remaining debts of the insolvent estate).

4.3 What is the effect of each procedure on employees?

The agreements entered into between the employees and the company become subject to amendment, suspension or termination, including those relating to severance payments, or golden parachutes of high-ranked employees.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

Any bilateral agreement entered into between the company and a third party, which has not been completely performed at the date of the declaration of the insolvency, will be suspended until the administrator of the insolvency decides whether or not to comply with such agreement. However, the third party may determine a term for the administrator decision. Once this term has elapsed, the agreement would be considered as annulled.

In case the agreement is annulled, any party is entitled to be reinstated in the situation existing before the execution of such agreement. If the insolvent estate has already performed any of its obligations under the agreement it is entitled to demand the other party to comply with its obligations; on the contrary, the other party will be entitled to demand from the insolvent estate any amounts due under the terms of the agreement, if it has already complied with its obligations.

Regarding the sale and purchase agreement with retention of title in which the insolvent company was the seller, the other party is entitled to demand the fulfilment of the agreement's obligations if the property has already been in the possession of the purchaser. This rule is also applicable to the leasing agreement.

5 Claims

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

During the insolvency proceedings, the administrator will assess and quantify the claims against the debtor company. The creditors will be able to submit their claims by lodging them with the administrator. When filing their claims, the creditors should give details of: (i) the nature, amount (principal and interest) and due date of the claim; (ii) if the claim is subject to any condition; (iii) if it is a common, subordinated, guaranteed or privileged claim; (iv) the existence of any personal guarantees of the claim and who the guarantors are; and v) the applicable interest rate.

A creditor is required to submit to the administrator a formal, written claim referred to as a "proof of debt". In general, all claims are provable, whether they be present or future, contingent or vested in the creditor and whether arising from contract, tort, breach of trust, statute or in any other manner. Rent and other payments of a periodic nature may be evidenced up to the date of the declaration of insolvency and thereafter as they fall due (unless they are payable as a debt of the insolvent estate in which case they are likely to be paid in full). Interest is only provable up to the last day of the time period for making claims.

5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

After having paid the debts of the insolvent estate, the administrator may begin to make the payments to other creditors of the debtor according to the following order: (i) guaranteed creditors (*credores garantidos*) - which comprises secured claims and special preferred claims (for example, claims of the employees); (ii) privileged creditors (*credores privilegiados*) - regarding generally preferred claims over the assets of the insolvent estate; (iii) common creditors (*credores comuns*) - regarding unsecured and unsubordinated creditors whose claims will be satisfied on a *pro rata* basis, depending on the value of the insolvency assets; (iv) subordinated creditors (*credores subordinados*) - the payment of these claims occurs after all of the other creditors of the debtor having been fully paid, in the order set forth in article 48 of the Insolvency Code, on a *pro rata* basis.

5.3 Are tax liabilities incurred during each procedure?

All the transactions executed under the insolvent proceeding are exempt of tax liabilities.

6 Ending the Formal Procedure

6.1 Is there a process for "cramming down" creditors who do not approve proposals put forward in these procedures?

The court may refuse the confirmation of the insolvent plan if any creditor so requests, provided that the latter is not the plan proponent and that he submitted its opposition to the plan before its approval. This request may also be made by any creditor, shareholder or member of the debtor.

Additionally, the petitioner must also prove that (i) if the plan is fully accomplished it will be in a less favourable situation than it would if the plan was not implemented; or (ii) the plan gives to a creditor claim an economic value higher than the amount acknowledged by the court.

6.2 What happens at the end of each procedure?

An insolvency procedure ends upon the declaration of the court. Even if the company is to be liquidated and dissolved at the end of the procedure, it will not be discharged of its liabilities. All creditors whose claims have been acknowledged have an enforceable instrument and the closing of the insolvency proceedings does not discharge the liabilities of the company.

If the proceedings continue after the declaration of insolvency, the court will order the closing of the proceedings: (i) after the final distribution of assets; (ii) after the period for appealing the court decision confirming the approval of an insolvency plan (unless the insolvency plan provides otherwise); (iii) upon the request of the debtor when the insolvency situation ceases or if all creditors vote in favour of the closing of the proceedings; or (iv) when the administrator comes to the conclusion that the insolvent estate is not sufficient to pay the court costs and the remaining insolvency debts.

Once the insolvency proceedings are closed, the debtor regains the right to manage its business and to dispose of its assets (notwithstanding the effects of the rules regarding culpable insolvency). The insolvency creditors may exercise their rights against the debtor without restrictions except for those set forth in the insolvency plan. The creditors of the insolvent estate may also claim the payment of their remaining debts.

If the insolvency proceedings are closed following the confirmation of an insolvency plan that foresees the continuation of the company, its activity will continue despite any shareholders' resolution.

Upon the registration of the closing of the proceedings due to the final distribution of assets, the company ceases to exist.

7 International

7.1 What would be the approach in your jurisdiction to recognising a procedure started in another jurisdiction?

The advertising and the registration of an insolvency proceeding started in another EU Member State must be authorised by a Portuguese court, upon request. Should the insolvent own any business entity in Portugal, the petition should be filed with the court of the area where that entity is located and, once authorised, the announcement in the official gazette is formally ordered. If the debtor does not own any business entity in Portugal, the competent court should be the Commercial Court of Lisbon or the Civil Court of Lisbon, depending on whether a company is part of the insolvent estate.

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Before being a lawyer at Uría Menéndez, he used to practice law in Macau, being qualified to practice in Portugal and Macau, and he also has been advisor to the Portugal Minister of Justice.

URÍA MENÉNDEZ

Uría Menéndez is an independent law firm founded in the 1940's by Professor D. Rodrigo Uría González. The firm currently has fourteen offices in Spain, Portugal, Europe and The Americas. Uría Menéndez specialises in providing legal advice to Spanish, Portuguese and European Community based businesses. The firm also provides support to its clients through its network of offices and through its relationships with equally prestigious international law firms.

The comprehensive legal advice provided by Uría Menéndez covers all areas of Commercial Law. With regard to insolvency matters, we provide advice to all the parties that may be involved in a company crisis, covering all kinds of situations. These include, amongst others, company or group restructuring procedures, refinancing of debts, acquisition of distressed assets and debt, protection of creditors' rights, directors' duties and liabilities, protection of assets, claw-back actions, design of security structures, corporate recovery as well as general advice on insolvency proceedings and related litigation. Uría Menéndez's high level of expertise in insolvency matters covers a broad range of economic sectors including, amongst others, industrial companies, banks, financial and insurance institutions, technology, construction and real estate. This expertise enables us to deal with insolvency situations with an intricate knowledge of the practical business issues and cross-border consequences in foreign insolvency cases.